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Memorandum

To: The State of Vermont
From: Public Financial Management, Inc.
Re: Financing Structures for the Vermont Futures Project

The purpose of this study is to provide a financial analysis of the proposed Vermont Futures Project (VFP). This analysis will discuss the timing and associated costs to develop the project including identification of projected revenues and expenses. As a result of materials submitted during the proposal process and discussions with state agencies and other participants in VFP, PFM has developed an outline of the financial structures that are options for the state to consider as it develops the VFP. In addition to the presentation of each structure, the cost components of each option are identified and a discussion of the benefits and risks of each option is presented. In all cases, the options evaluated did not include any financing structures that could be construed as incurring debt on the part of the State of Vermont or its partner in this program, Rutland Regional Medical Center (RRMC).

During the 2004 session of the Vermont legislature set in motion a strategic process to create a comprehensive plan for the delivery of services currently provided by the Vermont Mental Hospital. The plan proposed new investments in essential community capacities and reconfiguring the existing 54-bed inpatient capacity at the Vermont State Hospital (VSH) into a new system of inpatient, rehabilitation and residential services for adults. As a result of extensive study and a competitive request for bids, the Department of Mental Health (DMH) has focused on an expansion of the inpatient capacity at Rutland Regional Medical Center as the first phase of its alternative facility development.

Description of the Program

RRMC is submitting its bid to DMH for the development of 28 beds, half of which would be used by DMH and the other half would be occupied by patients currently being served through RRMC's existing psychiatric unit. The new facility with an estimated construction cost of \$25 million, would be constructed as attached to RRMC and would service both RRMC patients and VSH patients who otherwise would have been served at VSH. This facility would be owned and developed by Rutland Regional Psychiatric Services (RRPS), a wholly owned subsidiary of RRMC. For the analysis contained in this memorandum all dollars are expressed in current 2009 dollars unless otherwise noted.



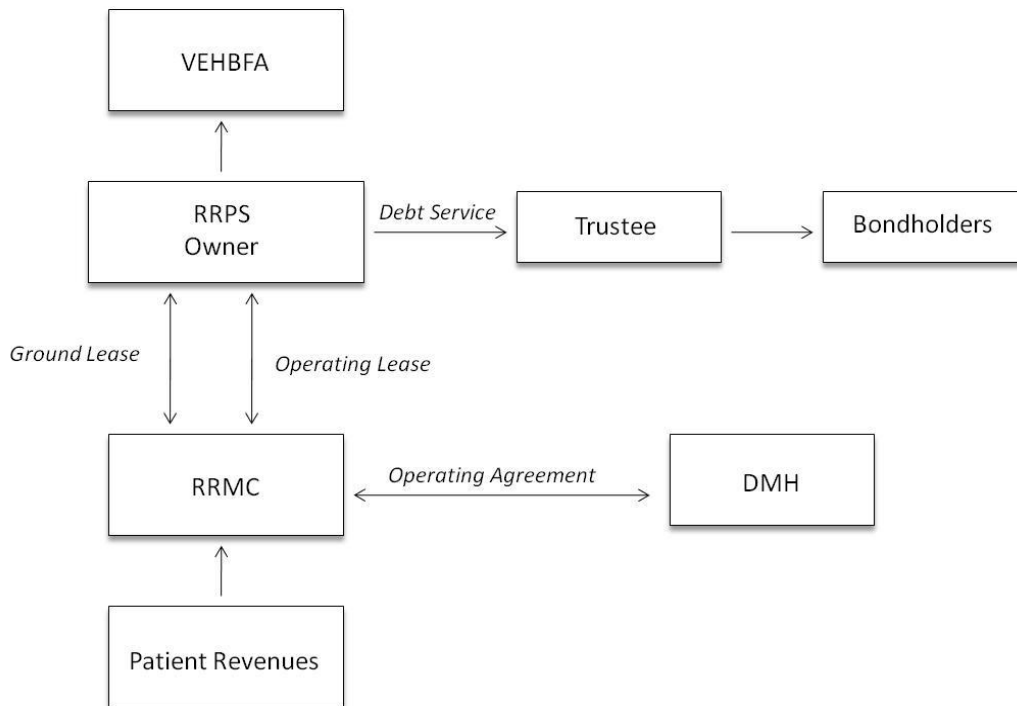
Rationale for the Facility

VSH currently pays \$1,420 per patient per day. The current limitations on reimbursement for federal Medicaid funding for patients treated at VSH is a significant contributor to the high patient per diem costs paid by the State. DMH estimates that it could save \$963 per patient per day by treating patients at the RRPS facility. The majority of the savings would be generated through receipt of federal reimbursement contributions not currently available to DMH due to restrictions at VSH. It is currently estimated by DMH that the state's share of net annual medical expense would be \$1.725 million less than what is required to serve those approximately 12 patients currently at VSH.

The economic rationale for this proposal is that even when development and capital costs are fully factored in, participation in the RRPS project would reduce the State funding required to treat 12.5 patients by \$1.725 million annually through the State's ability to utilize federal Medicaid dollars to offset the expense of treating those patients.

Proposed Transaction Structure

PFM has been asked to discuss the transaction structure as it is currently envisioned. A diagram of the transaction as currently proposed is presented below. The proposed facility will be developed and owned by Rutland Regional Psychiatric Services (RRPS), a separately formed 501 (c) 3 organization, the sole mission of which is to own the facility. It is not anticipated that RRPS will have any assets other than the facility. RRPS will have separate governance from that of RRMC although the exact make-up of the Board has not yet been determined. RRMC will enter into a ground lease with RRPS to convey the property to RRPS for the development of the facility. The term of the lease will be at least as long as the outstanding term of the transaction used to finance the facility. RRMC will also enter into an operating lease with RRPS under which RRMC will agree to pay lease payments to RRPS. The amount of those payments will be approximately equal to the amount required for debt service on the facility. RRPS will request that the Vermont Educational and Health Buildings Financing Agency (VEHBFA), as the conduit financing entity for 501 (c) 3 borrowers in Vermont, issue lease revenue bonds on its behalf to finance the facility. RRPS will pledge to use revenues received by it under the operating lease with RRMC to pay the debt service on the bonds. The payments will be paid to a Trustee who will distribute the debt service payments to the Bondholders. VEHBFA, as a result of its being a conduit issuer of bonds, would not be obligated on the debt of the bonds; the debt would remain an obligation of RRPS. Should RRPS neglect to pay debt service, the Trustee would use its powers under the documents to seek other remedies to make the bondholders whole. A fuller discussion of the default scenarios are presented later in this analysis.



A condition precedent to entering into either the ground lease or the operating lease with RRPS is the successful negotiation of an operating agreement between RRMC and the State through its Department of Mental Health. The Operating Agreement would set forth a number of the important contractual elements of the relationship between RRMC and DMH regarding the operation of the facility and patients formerly treated by the VSH. The Operating Agreement would set forth the designation of RRPS as a designated facility of the State to treat psychiatric patients committed to the care of the State. The term of the Operating Agreement would be coterminous with the length of the designation of the facility and would be renewed upon: (1) the renewal of the facility as a designated facility of the State and (2) RRMC and DMH being in agreement on the terms of the operating rules and costs set forth in the agreement. Under the Operating Agreement, RRMC would agree to accept and treat State patients based on an annual average census of 12.5 beds. Occupancy would be determined by the actual patient census taking into account both State and RRMC psychiatric patient admissions. RRMC and the State would develop a prospective operating cost for the facility and set forth a patient per diem fee based on the patient census actually experienced at the facility for the previous year. The per diem cost would include a cost component for operating costs, a capital charge and a contingency reserve. This would be the amount that would be budgeted and appropriated by the State. At the end of each year, the State would conduct a true up with RRMC to account for the actual patients served and the total reimbursement received for patients in the State's care. The patient census would then become the new baseline for the subsequent year. Each year during the budget cycle, RRMC and DMH will negotiate the next fiscal year's cost components. The term of the initial operating lease is four years or the length of the term of the State's designation. The operating agreement's cost component



would be reviewed and negotiated each year. A new operating agreement will be entered into during each designation cycle. The operating agreement would remain in effect as long as RRMC and the State could come to an agreement regarding the appropriate operating costs. If the State and RRMC cannot come to an agreement, or RRMC does not meet the operating standards of DMH, the State can seek the remedy of not renewing the operating agreement with RRMC and seek with the help of RRPS and the Trustee, a new operating entity for the facility. The State is not obligated to step in to make lease payments to RRPS in RRMC's stead. The State however, will continue to have the responsibility to treat the patients in its care and they will be obligated to find another operator or facility to treat those patients. It is anticipated that if either RRMC or the State elects not to renew the operating agreement for cause that the operating agreement would need to continue in place until the time a new operator could be found or the State had suitable alternate accommodations for the patients housed at RRPS.

Investor Risks

As we began to develop a more detailed transaction structure and began to discuss the transaction in further detail with financial institutions, a number of potential risks were identified that may need to be mitigated in the business deal between parties.

Length of the Operating Agreement – As currently anticipated, the Operating Agreement between RRMC and DMH will be set for the term of the designation of the facility by DMH with fees renegotiated annually and subject to mutual agreement. Typically the length of the operating agreement is co-terminus with the financing. To mitigate this risk, it may be necessary for both RRMC and DMH to covenant that if there is not agreement to renew the operating agreement either due to dissatisfaction with the operating entity or associated costs, THAT notification would be given to the trustee and that the agreement would continue in effect for a set period of time that would allow either RRMC to be replaced as operator or DMH to relocate patients to a suitable replacement facility.

Length of the Operating Lease with RRPS – RRMC has requested that the term of the operating lease with RRPS be one year with annual renewals. They have requested this structure in order to ensure that the obligation is booked on their balance sheet as an operating expense and not a capital obligation. Since the source of debt service to the bondholders is the pass-through of revenue under the operating lease, a single year does not provide much security. At a minimum, the operating lease should be co-terminus with the length of facility designation, currently 4 years, also allowing for adequate notice and remedies if redesignation does not occur. With a relatively short lease term in the 4-5 year range, RRMC's auditors should be comfortable not classifying this lease as a capital lease.

Substitution of a lower cost facility – Another risk upon which the investor will focus is the ability of the State to move patients to a lower cost facility over time. The investor may require that the State covenant not assign patients to another facility if the occupancy at RRPS is below a specified level. The development of the facility is predicated on having a full patient census available



to fill RRPS. Should the patient load be reduced, it would necessitate an increase in the operating costs which would be passed through to the State in the per diem charge.

Restrictions on the use of the facility – In the case of the non-renewal of the operating agreement between RRMC and DMH, or the loss of designation of the RRPS facility, RRMC is seeking a restriction that the facility can only be used as a psychiatric facility. The remedy to this event would be to have the trustee with the assistance of DMH, seek a replacement operator for the facility. If a replacement operator cannot be found, investors may require that an alternate tax-exempt use be sought for the property to the benefit of the bondholders. Under this scenario, the facility would not revert back to RRMC until all outstanding bonds have been paid.

Healthcare Reform – Since a significant portion of the revenues available to offset costs related to the operation of RRPS are related to the Medicare and Medicaid programs, any major changes to the reimbursement formulas for mental health services could affect project economics as currently presented.

Security Features

Historic Patient Census – The State is required to treat patients committed to its care. The demonstrated demand for beds currently serving VSH patients is strong and is expected to continue. RRMC also has an established practice of serving patients with an average occupancy rate of 80%. The projected occupancy rate for the facility is well within the conservative range considering the additional beds at VSH that will still be in need of replacement.

Demonstrated Cost Savings for the State – The RRPS option provides a higher level of service at more cost effective rates than the patient cost per day at VSH. A portion of these savings accrue from the more favorable federal reimbursement that patient treated at RRPS will qualify for given the nature of the facility. The State has strong economic incentives to participate in the RRPS; approximately \$1.7 million in annual savings over the alternative of providing services at VSH.

Financing Alternatives

Variable Rate Demand Bonds - Variable Rate Demand Bonds (VRDBs) allow a borrower to issue long-term debt at short-term rates. A distinct feature of this debt product is that it requires liquidity and credit enhancement from a Letter of Credit (LOC) bank¹. The rate on VRDBs is set periodically (usually weekly) by a Remarketing Agent (usually an Investment Bank) at the lowest rate that will sell all the bonds. VRDBs can be amortized over 30 years (or more or less, depending on the economic lives of the projects being financed). VRDBs are pre-payable at anytime at a price of par. A formal public rating is required by investors, who are usually institutional money market funds. The rating is based on the credit of the LOC bank. With the recent market turmoil and

¹ Under certain circumstances, highly rated borrowers can issue VRDBs with just liquidity and not credit enhancement.



increased focus on credit, many investors are now demanding an underlying rating. Therefore, it is possible that an underlying rating may be required for a VRDB issue.

VRDBs carry several considerable bond risks:

- **Interest Rate Risk**² - The risk that interest rates will increase after the issuance of the bonds. The variable nature of the interest rates makes predicting the annual rate on the bonds impossible.
- **Remarketing / Put Risk** – The risk that the Remarketing Agent will be unable to find investors for the bonds, resulting in the bonds being “put” (i.e. tendered) back to the LOC bank. In this case, two things happen:
 - The rate on the bonds jumps to a predetermined taxable bank rate, usually 12%, or Prime or LIBOR plus a spread;
 - Should the remarketing agent be unable to place/sell the bonds held by the letter of credit bank to new investors for a period of up to 90 days (usually, but can be longer or shorter), the bonds convert to a “term loan” whereby the balance of the loan amortizes over a period of up to three (3) years (usually, could be longer or shorter). During this period the borrower has the option of refinancing the loan with another loan product.
- **LOC Renewal Risk** - The term of the LOC contract is between 1-5 years (usually). At the end of the term, the LOC bank has the right to terminate the contract, forcing the borrower to find another LOC bank or refinance with another loan product. Additionally, at the time of renewal the LOC bank has the option of renegotiating the terms of the contract, including pricing and covenants.

The upfront issuance costs for a VRDB transaction is similar to those for fixed rate public offerings, but there are a few additional costs associated with the LOC bank and its counsel. On the other hand, the underwriter’s compensation for VRDB deals is typically lower than that of fixed rate issues. VRDBs carry several ongoing fees such as annual remarketing, LOC and trustee fees as well as an annual rating surveillance fee. The table on the following page illustrates estimated upfront issuance and ongoing costs for a VRDB, private placement and fixed rate transaction.

Due to the variable nature of VRDBs, an all-in borrowing cost can only be estimated. On a thirty year financing, if we assume the average SIFMA rate since 1993 (approximately 2.72%), plus 0.10% for the annual Remarketing Agent fee, plus 3.10% for the annual LOC fee and 0.27% bps for the annualized upfront issuance cost, the all-in borrowing rate is 6.09%³.

² Interest rate swaps can be used to mitigate interest rate risk.

³ “SIFMA” stands for Securities Industry and Financial Markets Association. SIFMA produces an index of high grade weekly variable rate demand notes. It is used by the municipal market as an index for tax-exempt variable rate bonds.



Interest rate swap can be utilized to mitigate interest rate risk and “effectively” lock in a borrowing rate for a specified period of time⁴. Historically, issuers have used interest rate swaps to mitigate interest rate risk obtain and effectively fixed borrowing cost. These “effectively fixed” interest rates have traditionally been lower than comparable traditional fixed muni rates, however, interest rate swaps come with several considerable risks as well as additional upfront costs. Additional upfront costs include legal fees associated with drafting swap documents as well as swap advisor fees associated with competitively bidding the swap and document negotiation.

Interest rate swap risks include:

- **Counterparty Risk** – The possibility that the Counterparty will not be able to fulfill its obligations as specified by the terms of the swap transaction
- **Termination Risk** – The potential for the swap to be terminated (either voluntarily or involuntarily) prior to its scheduled termination date at a time when the market value requires a payment from the Issuer to the Swap Counterparty
- **Basis Risk** – The (typically temporary) mismatch between the rate received by the Issuer under a swap agreement and the rate payable by the Issuer on outstanding bonds
- **Tax Risk** (only with a % of LIBOR Swap)– A permanent form of basis risk resulting from structural changes that cause a reduction in or elimination of the benefits of tax-exemption for municipal bonds
- **Collateral Posting Risk**- The risk that an Issuer may have to post collateral in favor of the swap Counterparty under certain circumstances.

The list of firms that provide LOCs has shortened significantly since the market turmoil that began in the fall of 2008. Firms that are active in the LOC market and Vermont include Bank of America, TD Securities and Wells Fargo (Wachovia). Other firms active in the LOC market include JP Morgan and U.S. Bank. There are several other firms that have participated in the market, but their activity has slowed down over the past year. These firms may return to the LOC market in the future as liquidity returns to the credit markets.

Private Placement - A direct Private Placement is like VRDBs in that it is usually a variable rate product, but it has several differentiating and unique features. A Private Placement typically is sold directly to a bank which holds the loan until maturity. The variable rate is usually based on a taxable index (e.g. 1-month LIBOR) with a credit spread is added. The credit spread would be similar to the annual fee for a LOC. For example, assuming a credit spread of 1.50%, a borrowing rate formula might be 67% of 1-month LIBOR + 1.50%. Unlike VRDBs, Private Placement loans do not need a LOC or a Remarketing Agent and therefore do not have LOC renewal and remarketing risk. In the current market, most private placements are amortized over 20-30 years, but the tenor of the loan is only 3-5 years (could be longer or shorter); therefore, there is a balloon payment at the end of the 3-5 year period which needs to be refinanced or paid in full. The shorter term of the loan introduces market access risk, which is the risk that a borrower may not have access to financing in the future

⁴ While the borrowing rate could effectively be locked in, the requisite ancillary fees such as remarketing and letter of credit could change.



either due to internal credit problems or challenges in the market in general. The short tenor effectively serves as a “put” and allows the bank to renegotiate pricing and terms of the loan. Like VRDBs, variable rate Private Placement loans can be pre-paid at anytime without penalty. A public rating is not usually required.

The upfront issuance costs for a Private Placement transaction are usually lower than those of fixed rate and VRDB public offerings. This is because there is no underwriter or rating fees. In addition to lower upfront fees, there are very few ongoing fees as no LOC bank, Trustee or Remarketing Agent is required.

In some circumstances, borrowers will elect to swap the Private Placement to a fixed rate. By doing this, the borrower absorbs all the swap risks described above except one: basis risk. Since the variable rate swap rate received by the borrower and the variable rate paid to the bank are usually structured to match exactly, there is no room for a potential mismatch in payments.

The firms who are interested in purchasing Private Placement loans are usually the same as those who offer LOCs. RBS Citizens is a firm that was active in the LOC market but due to a recent rating downgrade it is considerably less active. It is however active in the Private Placement market and could have interest in this transaction.

Since Private Placements are also variable rate, an all-in borrowing cost can only be estimated. On a thirty-year financing, if we assume 67% of the average 1-month LIBOR rate since 1993 (approximately $4.01\% \times 67\% = 2.69\%$), plus 3.00% for the annual credit charge and 0.18% bps for the annualized upfront issuance cost, the all-in borrowing rate is 5.87%.

Natural Fixed Rate Bonds - In a natural fixed rate public offering, all of the risks are transferred to the investors. The principal and interest requirements are set at closing and there is complete budget certainty. Natural fixed rate bonds can be amortized over 30 years (or more or less, depending on the economic lives of the projects being financed). Fixed rate bonds can be sold at a premium or a discount, depending on investor and issuer preferences. The bonds are typically structured with a 10-year par call. While these bonds have traditionally carried municipal bond insurance, currently, there are a limited number of viable insurance companies. In today's market, a formal public rating is required by investors. Therefore, if insurance is not obtained, an underlying rating will likely be required.

The upfront issuance costs for a natural fixed rate transaction is similar to those for VRDBs, but the underwriter's compensation typically higher. There are very few ongoing costs for natural (i.e. not insured) fixed rate deals.

On a thirty-year financing, if we assume current borrowing spreads (MMD + 2.50 - 3.50%), the all-in borrowing rate is between 6.74 - 7.79%.



Estimated Upfront Costs

Estimated Cost of Issuance Budget for \$25MM Bonds							
	Variable Rate Demand Bonds		Private Placement		Fixed Rate Bonds		
	Lower End	Higher End	Lower End	Higher End	Lower End	Higher End	
Issuers Fee (VEHBFA)	\$ 25,000	\$ 50,000	\$ 25,000	\$ 50,000	\$ 25,000	\$ 50,000	
Underwriter's Compensation	75,000	125,000	-	-	100,000	225,000	
Bond Counsel	50,000	80,000	50,000	80,000	50,000	80,000	
Underwriter's Counsel	35,000	60,000	-	-	35,000	60,000	
Counsel to Letter of Credit Bank	35,000	50,000	-	-	-	-	
State of VT's Counsel	35,000	50,000	35,000	50,000	35,000	50,000	
RRMC's Counsel	35,000	60,000	35,000	60,000	35,000	60,000	
Bond Trustee's Counsel	-	10,000	-	-	-	10,000	
Letter of Credit Bank Fee	25,000	50,000	-	-	-	-	
Counsel to Private Placement Bank	-	-	40,000	60,000	-	-	
Bond Trustee	-	7,500	-	-	-	7,500	
Rating Agency 1	20,000	40,000	-	-	20,000	35,000	
Financial Advisor to State	20,000	50,000	20,000	50,000	20,000	50,000	
Financial Advisor to RRMC	20,000	50,000	20,000	50,000	20,000	50,000	
Printer / Mailing	3,000	10,000	-	-	3,000	10,000	
Total	\$ 378,000	\$ 690,000	\$ 225,000	\$ 400,000	\$ 343,000	\$ 685,000	

Notes:

All fees are estimates. Estimates are based on 2008 mental health provider / VEHBFA insured fixed rate transaction as well as quotes from recent comparable transactions. Actual fees could vary significantly from what is shown above.

Estimated Ongoing Costs

Estimated Ongoing Costs for \$25MM Bonds			
	Variable Rate Demand Bonds	Private Placement	Fixed Rate Bonds
ONGOING COSTS			
Issuers Fee (VEHBFA) Annual Fee	\$1,500 - \$2,500	\$1,500 - \$2,500	\$1,500 - \$2,500
Bond Trustee Annual Fee	\$2,000 - \$5,000	None	\$1,000 - \$4,000
Rating Agency 1 (Surveillance Fee)	\$3,000 - \$10,000	None	\$3,000 - \$10,000
Letter of Credit Annual Fee	250 - 350 bps x (Par + 35 days interest)	None	None
Remarketing Agent Annual Fee	8 - 12 bps x Par	None	None

Notes:

All fees are estimates. Estimates are based on quotes from recent comparable transactions. Actual fees could vary significantly from what is shown above.



Estimated Borrowing Costs

Figures in \$ Millions

	Variable Rate Demand Bonds	Private Placement	Fixed Rate Bonds
30-year Amortization			
All-in Borrowing Rate (1)	6.09%	5.87%	6.74 - 7.79%
Average Annual Debt Service	\$1.81	\$1.77	\$1.94 - 2.15
Total Debt Service	\$54.86	\$53.62	\$58.64 - 64.93
20-year Amortization			
All-in Borrowing Rate (1)	6.15%	5.91%	6.63 - 7.68%
Average Annual Debt Service	\$2.18	\$2.14	\$2.26 - 2.45
Total Debt Service	\$44.12	\$43.28	\$45.84 - 49.62
Assumptions			
Total Cost of Issuance	\$0.535	\$0.313	\$0.628

Notes:

Assumes historical average SIFMA and 1-month LIBOR rates for the VRDB and Private Placement structures.

Fixed rate bonds borrowing rate estimated at 9/23/09 AAA MMD + 250-350 bps.

All structures assume a project fund deposit of \$25MM.

Conclusion

In response to the State's request, PFM surveyed a broad range of potential institutional letter of credit providers and potential institutional investors to determine whether, as currently structured, this transaction could be financed under current market conditions. The results of our discussions revealed the following. First, the credit crisis that began 18 months ago remains a significant impediment to successfully financing this type of transaction. The number of credit providers has contracted significantly and among those who remain, the numbers who are active in the healthcare sector is very small. As such, the types of transactions that are being financed are traditional structures with minimal risk to the lender. Secondly, the investor feedback received indicated that the structure of the financing contained several features which in the current marketplace would limit the number of participants who would consider this transaction for investment. Among those elements discussed were the length of the term of the facility designation, the length of the term of the operating lease, the restrictions on the use of the facility if a replacement operator is sought and the lack of assets being held at the special purpose 501 (c) 3 entity. The overriding concern of the potential credit providers and investors however, was the assessment that neither the State nor RRMC was at risk for non-performance under the operating agreement or the operating lease and that the lender was ultimately the party that bears the risk of non-payment. Apart from the specific transaction issues, the other major concern of investors is impact of the on-going federal debate on healthcare on reimbursement regulations. As currently structured, the cash flow from this transaction relies heavily upon the State's receipt of federal Medicaid dollars and the uncertainty created by proposed federal legislation makes it difficult for proposed lenders to evaluate potential risk.

The challenge in financing a project such as the one proposed, is that potential investors are being asked to provide feedback regarding a transaction that is not expected to come to market within the



next 24 months. Given the uncertainties created by the market dislocation of the last 18 months, few investors are willing to give definitive indications of interest at this time but rather will prefer to express an opinion when the project is closer to coming to market and they are better able to assess the credit availability and market risk that will be present at that time.



Appendix - Investor Feedback

Bank #1 –Major Money Center Bank – LOC only

In examining the term sheet and from subsequent discussions with the PFM team, the following issues were presented regarding the structure:

A

Lack of a balance sheet – RRPS being set up for the sole purpose of this financing has no other assets other than the facility. This is seen as a weakness since there are no other sources of equity for the investor to look to in the case of default. It was felt that either a clawback to the State or RRMC would be required.

Term of the designation – Four years was seen as relatively short. If the designation period could be extended longer it would provide more support to the financing.

Reserve Fund – The use of a reserve fund would be required to insulate the investor from any payment timing mismatches due to late appropriations or late reimbursement payments.

Operating lease between RRPS and RRMC – The operating lease would need to be as long as the designation of the facility which would make it the same length as operating agreement between RRMC and DMH.

Ability to replace RRMC – It was felt that one of the remedies would need to be replacement of RRMC if no consensus was reached on the operating agreement renewal or for cause. There was a question however whether there were any entities that could practically step into RRMC's role as operator and whether this was actually a viable option.

The final assessment of this lender was that this would be a very difficult structure to finance for several reasons. First, the dollars allocated within the bank for healthcare very limited and therefore they would most likely be allocated on a transaction that was more conventional with fewer risks. Secondly, psych projects have traditionally been difficult to finance due to narrow profit margins. Thirdly, the lack of resources at the RRPS level was considered a weakness. In the case of a default, the investor cannot look to RRPS, RRMC or the State to make him whole. It was felt that there was not enough security in the transaction as currently structured for this lender given their institutional constraints in committing capital.

Bank #2 – Investment Bank – Private placement structure

In discussing the term sheet, the most likely scenario for this investor would be a direct placement with sophisticated investors, likely high net worth individuals. Most likely the transaction would be done on a best efforts basis. This institution felt the highest success outcome would be if they were allowed to participate in the final structuring of the transaction as opposed to being asked to market a transaction that had been fully structured. It was felt that the key to placing this transaction would



be to educate the buyers on the role of the State in the transaction and the essential nature of the facility and the service being provided.

Bank #3 Regional Bank – LOC only

In reviewing the term sheet this institution was interested in providing credit enhancement only and would not be the source of direct lending. The bank also noted that if they were to provide a letter of credit it would also be requiring an additional banking relationship from the State or RRMC.

Their overall criticism of the structure was the after all remedies were exhausted, there still was not a single entity that they could look to that would make the institution whole, i.e no single entity was obligated on the facility that had could provide a back-up source of repayment.. After review of the term sheet, the following issues with the structure were identified:

Lack of equity at the RRPS – Because of the single purpose nature of the 501 (c) 3, there are no additional assets that a lender could look to in the case of non-payment. Typically there are other assets even modest ones as with the case of the Community mental health providers that can serve as a source of repayment.

Lack of marketable collateral - The lack of equity at the facility owner's level is further compounded by the single purpose nature of the facility that does not easily lend itself to other substitute uses. In the opinion of this institution, this does really provide meaningful collateral to the lender. There was recognition that the level of patient demand and lack of other facilities with the same economic benefits to the State to treat these patients was an important factor it did not however, make up for the lack of collateral.

Cash flow analysis – Given the other factors cited above, the bank felt that the focus would then fall to the security of the cash flow. They would look for covenants on high occupancy and focus on the contract between RRMC and the State. They indicated that the longer the term of the operating agreement, the stronger the credit and felt that longer than five years would be a credit enhancement. The lender would be looking to the operating agreement to define the specific cash flow from the State and that this would be the focus of the credit analysis.

At the end of the day, this lender did not think they could approve the credit as currently structured because they did not see a scenario where in the case of non-performance by either the State or RRMC that there was a way to protect themselves from owning a non-performing asset with limited value. They felt that ultimately that the project needed a sponsor that would step up should the cash flow not be sufficient and the project not perform. The lender was not willing to take that risk.

Bank #4 – Regional Bank – LOC or Direct Placement

This institution has significant operations on the State and has current exposure to the State's credit. It also has a business relationship with a number of state entities which give them more familiarity



with the State and its credit. This lender is willing to consider both an LOC structure as well as a direct placement.

Length of transaction – In the case of an LOC the lender would be looking to a 3 to 5 year term. In the case of a direct placement, the term could be 20 years but with a put for the bank at 10 years and a renegotiation of the rate and terms of the transaction at that time for the balance of the loan.

Term of the Operating Agreement – This lender felt that it was important that the term of the operating agreement be co-terminus with the term of the financing, i.e. 10 years. It could be structured to allow the State to terminate it for cause should RRMC not perform but that absent direct action it would remain in place for 10 years. They were comfortable with the agreement being subject to annual appropriation if it allowed the State to lengthen the designation period and extended the agreement to be 10 years, co-terminus with the first term of the financing.

Covenant regarding occupancy – This institution was concerned that the competing institutions could be developed across the state that would compete with this facility for patients. They felt that a covenant that would direct patients to this facility until a minimum occupancy was reached was an important mitigating factor.

Changes to reimbursement rates – This lender felt that it was taking on the significant risk that changes in reimbursement rates at either the state or national level would negatively impact the cashflow of the project and revenues pledged to meet debt service. They would need a mechanism in place that would assure them the required level of revenues would be available to service the debt and that they would not be taking reimbursement risk.

For this institution the key to whether they could support this transaction was the identification of what the long term source of repayment would be and what the security of that source would be. They indicated that they could see this transaction getting done if the final credit enhancement was ultimately the backing of either the state or RRMC. Short of having a guaranteed source of repayment, they felt that the collateral of the facility would not provide enough security in a default scenario and the risk associated with finding a replacement operator was high enough not to induce a lender to undertake the deal.

Bank #5 – Recently Merged Regional Banks – LOC or Direct Placement

After having reviewed the term sheet and the associated materials that were sent, their health care credit department said that this was not a credit that they would consider.



Bank #6 – Major Money Center Bank – LOC

This bank has a banking relationship with the State. They are not currently extending letters of credit in the healthcare sector. They did indicate if there was another consideration, i.e. some security tie to the State, they might be able to consider the financing.

Financial Institution #7 – Public Pension Fund – Direct Placement

This institution directly invests in private placement which it holds for its own account. It has also has been active in providing credit enhancement to certain credits. At this time, they are purchasing only highly rated credits limited to a few sectors which include general obligation and municipal utility bonds. Healthcare bonds are currently not on the approved list.